No. 92-854

In The

Supreme Court of the United States

October Term, 1993

CENTRAL BANK OF DENVER, N.A.,

Petitioner,

v.

FIRST INTERSTATE BANK OF DENVER, N.A. and JACK K. NABER,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

REPLY BRIEF FOR PETITIONER

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TABLE OF CONTENTS

Page

I. THERE IS NO IMPLIED PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING VIOLATIONS OF SECTION 10(b) AND RULE 10b-5 ... 1

A. The Language Of The 1934 Act Does Not Provide A Private Right Of Action Against Aiders And Abettors 1

B. An Analysis Of Congressional Intent Does Not Support Recognition Of An Implied Private Right Of Action For Aiding And Abetting.... 5

1. Aiding And Abetting Is Not Merely An "Aspect" Of The Implied Private Right Of Action Under Section 10(b) Previously Recognized By This Court..... 5

2. Congress Did Not Incorporate Private Aiding And Abetting Rights Into Section 10(b) In 1934..... 6

3. Congress Has Not Created A Private Right Of Action For Aiding And Abetting Under Section 10(b) Since 1934..... 8

C. Policy Considerations Do Not Warrant Creation Of An Implied Private Right Of Action For Aiding And Abetting 13

II. LIABILITY FOR AIDING AND ABETTING A VIOLATION OF SECTION 10(b) AND RULE 10b-5 SHOULD NOT BE IMPOSED BASED ONLY ON RECKLESSNESS IN THE ABSENCE OF A PRE-EXISTING DUTY TO DISCLOSE OR TO ACT .. 14

TABLE OF CONTENTS – Continued

Page

A. Aiding And Abetting Liability May Not Appropriately Be Premised On Recklessness In All Cases 15

B. Central Bank Should Not Be Subject To Liability Based On Recklessness Merely Because It Committed Some "Affirmative Act," Where It Owed No Pre-Existing Duty To Disclose Or To Act 18

TABLE OF AUTHORITIES

Page

CASES

American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp., 456 U.S. 556 (1982)..... 6

Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490 (7th Cir. 1986) 15

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) ..... *passim*

Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970) 10

Cannon v. University of Chicago, 441 U.S. 677 (1979) 12

Chiarella v. United States, 445 U.S. 222 (1980)..... 19

Cooper v. Schlesinger, 111 U.S. 148 (1884) 17

Cort v. Ash, 422 U.S. 66 (1975) 1, 6, 11

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)..... *passim*

Geo. H. McFadden & Bro., Inc. v. Home-Stake Prod. Co., 295 F. Supp. 587 (N.D. Okla. 1968)..... 2

Herman & MacLean v. Huddleston, 459 U.S. 375 (1983) 8, 10

In re Atlantic Financial Management, Inc., 784 F.2d 29 (1st Cir. 1986), *cert. denied*, 481 U.S. 1072 (1987) 2

J.I. Case Co. v. Borak, 377 U.S. 426 (1964)..... 1, 13

Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773 (1991) 4, 7, 8, 10, 17

Levine v. Diamanthuset, Inc., 950 F.2d 1478 (9th Cir. 1991)..... 15, 19

TABLE OF AUTHORITIES – Continued

Page

Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353 (1982) 6

Musick, Peeler & Garrett v. Employers Ins. of Wausau, 113 S. Ct. 2085 (1993) 4, 5, 6, 12, 13

Pettit v. American Stock Exchange, 217 F. Supp. 21 (S.D.N.Y. 1963) 10

Pinter v. Dahl, 486 U.S. 622 (1988) 4, 5

SEC v. Timetrust, Inc., 28 F. Supp. 34 (N.D. Cal. 1939) 10

SEC v. Universal Major Indus. Corp., 546 F.2d 1044 (2d Cir. 1976), *cert. denied*, 434 U.S. 834 (1977) 2

Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) *passim*

Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749 (1991) 1, 6, 14

STATUTES AND RULES

Securities Act of 1933, 15 U.S.C. §§ 77a-77bbbb (1988) 2, 5

§ 5, 15 U.S.C. § 77e (1988) 2

§ 12(1), 15 U.S.C. § 77*l*(1) (1988) 5

Securities Exchange Act of 1934, 15 U.S.C. §§ 78a – 78*ll* (1988) ..... *passim*

§ 7(f)(2)(C), 15 U.S.C. § 78g(f)(2)(C) (1988) 4

§ 9, 15 U.S.C. § 78i (1988) 4

TABLE OF AUTHORITIES – Continued

Page

§ 10(b), 15 U.S.C. § 78j(b) (1988) ..... *passim*

§ 11(d), 15 U.S.C. § 78k(d) (1988) 4

§ 12(b), 15 U.S.C. § 78*l*(b) (1988) 4

§ 13, 15 U.S.C. § 78m (1988) 4

§ 15, 15 U.S.C § 78o (1988) 4, 5, 11

§ 16(a), 15 U.S.C. § 78p(a) (1988) 4

§ 17(a), 15 U.S.C. § 78q(a) (1988) 7, 8

§ 18, 15 U.S.C. § 78r (1988) 4

§ 20, 15 U.S.C. § 78t (1988) 3, 7, 9

§ 21A(a)(3), 15 U.S.C. § 78u-1(a)(3) (1988) 4

§ 32, 15 U.S.C. § 78ff (1988) 7

18 U.S.C. § 2(a) (1988) 5

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 ..... *passim*

LEGISLATIVE HISTORY

H.R. 2480, 86th Cong., 1st Sess. (1959) 9

H.R. Rep. No. 355, 98th Cong., 2d Sess. (1983), *reprinted in* 1984 U.S.C.C.A.N. 2274 ..... 3, 11

H.R. Rep. No. 910, 100th Cong., 2d Sess. (1988), *reprinted in* 1988 U.S.C.C.A.N. 6043 12

S. 1179, 86th Cong., 1st Sess. (1959) 9

TABLE OF AUTHORITIES – Continued

Page

SEC Legislation: Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, 86th Cong., 1st Sess., on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182 (1959) 9

MISCELLANEOUS

Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80 (1981) 2

Joel S. Feldman, *The Breakdown of Securities Fraud Aiding and Abetting Liability: Can a Uniform Standard Be Resurrected?*, 19 Sec. Reg. L.J. 45 (1991) 16

John H. Karnes, Jr., *Lenders' Liability for Aiding and Abetting Rule 10b-5 Violations: The Knowledge Standard*, 41 Sw. L.J. 925 (1988) 3

W. Prosser, *The Law of Torts* § 339 (3d ed. 1964) 19

REPLY BRIEF FOR PETITIONER

I. THERE IS NO IMPLIED PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING VIOLATIONS OF SECTION 10(b) AND RULE 10b-5.

At one time, this Court was willing to recognize implied private rights of action whenever it felt they might further the protection of investors. The Court considered it "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *J.I. Case Co. v. Borak*, 377 U.S. 426, 433 (1964). In the nearly thirty years since that statement, the Court has moved dramatically away from this expansive approach to implied rights. The Court recognized the importance of the intent of Congress in *Cort v. Ash*, 422 U.S. 66, 78 (1975), and later, in *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575-76 (1979), deemed this to be the central inquiry in determining an implied private right of action. *See Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2763-64 (1991). Today Respondents, the Securities and Exchange Commission, and Respondents' amici ask this Court to return to 1964.[1] Although they offer some tortured reasoning to show that Congress actually incorporated aiding and abetting into § 10(b) in 1934, albeit not expressly, and has since condoned the implication of such a private right, the unmistakable thrust of their argument is that aiding and abetting is an effective tool for enforcing the securities laws. This is a determination best left to Congress, and Congress has as yet failed to create a right of action against aiders and abettors outside the criminal and disciplinary contexts.

A. The Language Of The 1934 Act Does Not Provide A Private Right Of Action Against Aiders And Abettors.

Section 10(b) prohibits "any person, directly or indirectly" from using or employing "any manipulative or deceptive device

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[1] Respondents even go so far as to assert that the "post-1975 test" should not be used in § 10(b) cases, because it "could only lead to a hodgepodge of inconsistent rules of law." (Resp. Br. 11.) If Respondents are correct, it is difficult to understand why the *Cort v. Ash* and *Touche Ross* standards were created at all.

or contrivance" in connection with sales of securities. Respondents and the Commission suggest that the "directly or indirectly" language is intended to reach aiders and abettors. (Resp. Br. 15; SEC Br. 8.) However, "there is no support for the proposition that Congress intended the 'directly or indirectly' language to encompass secondary liability. The statutory scheme suggests the opposite." Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80, 94 n.83 (1981).

The "directly or indirectly" language is better understood as intended not to create secondary liability against aiders and abettors, but instead to prevent the primary violator from immunizing himself from liability by acting through an agent[2] or other instrumentality:

> Although Rule 10b-5 provides for liability when the primary party perpetrates a violation indirectly, this is not secondary liability. Perpetrating an indirect Rule 10b-5 violation might consist of using an unwilling instrumentality to consummate the fraud. A secondary party, on the other hand, may not partake in the fraud, but rather may simply fail to intervene to stop it.

[2] The discussion in the most recent of the three cases cited by the Commission in support of its assertion that "directly or indirectly" refers to aiding and abetting is limited to the vicarious liability of a principal for the actions of an agent. *In re Atlantic Financial Management, Inc.*, 784 F.2d 29 (1st Cir. 1986), *cert. denied*, 481 U.S. 1072 (1987). This and the other cases cited by the Commission are consistent with the view that the phrase "directly or indirectly" is intended to prevent a primary violator from avoiding liability by acting through an agent or other instrumentality. *See SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1046 (2d Cir. 1976) (holding that a defendant in an action under § 5 of the 1933 Act need not be "the individual who actually consummated the sale"), *cert. denied*, 434 U.S. 834 (1977); *Geo. H. McFadden & Bro., Inc. v. Home-Stake Prod. Co.*, 295 F. Supp. 587 (N.D. Okla. 1968) (holding that privity is not essential in an action under Rule 10b-5). In general, lower courts have not concluded that the statutory language of § 10(b) encompasses aiding and abetting, "but rather have relied on various common law doctrines as the basis for secondary liability." Fischel, *supra*.

John H. Karnes, Jr., *Lenders' Liability for Aiding and Abetting Rule 10b-5 Violations: The Knowledge Standard*, 41 Sw. L.J. 925, 928 n.13 (1988).[3]

Respondents' and the Commission's assertion that "directly or indirectly" refers to aiding and abetting a primary violation cannot survive a review of Congress' use of the phrase elsewhere in the 1934 Act. Particularly instructive is § 20, which creates express secondary liability against "[e]very person who, *directly or indirectly*, controls any person liable under any provision under this title or of any rule or regulation thereunder." 15 U.S.C. § 78t(a) (1988) (emphasis added). Use of the phrase "directly or indirectly" can hardly be intended to impose aiding and abetting liability or any other form of secondary liability based on a primary violation of the statute, since the statute itself is directed only to secondary violations of the securities laws. As Respondents themselves point out in reference to the control person provision, "[t]here is no reason to suppose that Congress would even have considered providing for a remedy directed to 'aiding and abetting of secondary liability.' " (Resp. Br. 38 n.32.)[4] Respondents apparently agree that the phrase "directly

[3] Legislative history cited by Respondents and its amici supports this interpretation of the "direct or indirect" language. The House Report concerning the Insider Trading Sanctions Act of 1984, in explaining why secondary liability under the proposed legislation was to be sharply limited, distinguished between aiding and abetting and indirect primary violations:

> [I]f the board of directors of a corporation, while having material nonpublic information, directed an employee to trade for the corporation's account, the corporation itself would be liable for the penalty. In that situation, the corporation *would not be an aider and abettor, but would, in fact, be a direct violator* who traded on the inside information. . . . This result proceeds from the principle, recognized in section 20(b) of the Exchange Act, that *a person may not do indirectly what cannot be done directly*.

H.R. Rep. No. 355, 98th Cong., 2d Sess. 10-11 (1983), *reprinted in* 1984 U.S.C.C.A.N. 2274, 2283-84 (emphasis added).

[4] Respondents make this observation in response to an argument never advanced in Central Bank's opening brief.

or indirectly" in this provision cannot be read as synonymous with aiding and abetting.[5]

Aiding and abetting language is also conspicuously absent from §§ 9 and 18 of the 1934 Act, the civil liability provisions to which the Court looked for guidance in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991), and *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085 (1993). Section 9(e) creates liability against "[a]ny person who willfully participates in any act or transaction in violation of" the statute's prohibitions on manipulation of security prices. 15 U.S.C. § 78i(e) (1988). The Commission asserts without any supporting authority that the term "participates" in this provision "plainly encompasses aiding and abetting." (SEC Br. 9.) The statutory structure of the 1934 Act again counsels against the Commission's presumption that "participates" is used in lieu of the words "aids" and "abets." Section 15(b) of the 1934 Act in one paragraph expressly allows the Commission to censure aiders and abettors, 15 U.S.C § 78o(b)(4)(E), and in another paragraph grants the Commission certain powers over "any person participating, or, at the time of the alleged misconduct, who was participating, in an offering of any penny stock." 15 U.S.C. § 78o(b)(6)(A). Participation in a stock transaction and aiding and abetting are treated as separate concepts. As the statute goes on to make clear, participation contemplates some sort of primary role in the transaction, such as acting as a promoter, finder, consultant, or agent. 15 U.S.C. § 78o(b)(6)(C). This Court has similarly treated participation and aiding and abetting as distinct concepts under the securities laws. *See Pinter v. Dahl*, 486 U.S. 622 (1988)

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[5] Other provisions in the 1934 Act similarly employ the "directly or indirectly" language in contexts in which the phrase cannot meaningfully be interpreted as referring to aiding and abetting. *See, e.g.*, §§ 7(f)(2)(C) (directly or indirectly owning stock); 16(a) (same); 9(a)(5) (directly or indirectly receiving consideration); 9(b)(2),(3) (directly or indirectly owning an interest in certain securities); 11(d) (directly or indirectly extending credit to a customer); 12(b)(1),(2) (directly or indirectly controlling another entity); 13(b)(1) (same); 21A(a)(3) (same); 13(d)(1) (directly or indirectly acquiring ownership).

(holding that § 12(1) of the 1933 Act does not impose liability for "participation" in transactions in violation of that provision, *id.* at 650, but reserving judgment on the issue of whether the provision gives rise to liability for aiding and abetting, *id.* at 648 n.24).

In statutes written both before and after 1934, Congress has proved able to provide expressly for liability against aiders and abettors of securities violations in criminal and SEC enforcement actions. *E.g.*, 15 U.S.C. § 78o(b)(4)(E) (1988); 18 U.S.C. § 2(a) (1988). Respondents' and the Commission's strained efforts to show that the language of § 10(b) and related provisions encompasses aiding and abetting liability cannot overcome the simple fact that Congress did not include explicit aiding and abetting language in these provisions, where elsewhere it has.

B. An Analysis Of Congressional Intent Does Not Support Recognition Of An Implied Private Right Of Action For Aiding And Abetting.

1. Aiding And Abetting Is Not Merely An "Aspect" Of The Implied Private Right Of Action Under Section 10(b) Previously Recognized By This Court.

The Commission argues that a private right against aiders and abettors is akin to the right to contribution, which it asserts the Court in *Musick* treated as simply an "aspect" of the existing 10b-5 private right of action. (SEC Br. 6; see also Resp. Br. 11-12.) However, in dealing with rights to contribution, the Court needed only be concerned with how to allocate *existing* liability:

> The parties against whom contribution is sought are, by definition, persons or entities alleged to have violated existing securities laws and who share joint liability for that wrong under a remedial scheme established by the federal courts. Even though we are being asked to recognize a cause of action that supports a suit against these parties, the

> duty is but the duty to contribute for having committed a wrong that courts have already deemed actionable under federal law.

113 S. Ct. at 2088. In contrast, this Court has not previously deemed aiding and abetting actionable, but has expressly reserved the question. Since the existence of private liability for aiding and abetting under § 10(b) has not been established, the central question of whether Congress would have assessed liability against those who substantially assist, but do not commit, the primary wrong remains to be answered.[6]

Furthermore, the Commission's characterization of this case as a "rounding out" of the existing 10b-5 remedies (SEC Br. 7), even if accepted, does not alter the requisite congressional intent analysis. The Commission draws the phrase "rounding out" from the *Virginia Bankshares* opinion, and also cites *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), for the concept of "flesh[ing] out" an existing right of action. Yet both of these decisions emphasize that the Court's primary concern in defining implied rights of action under the securities laws is with congressional intent. *Virginia Bankshares*, 111 S. Ct. at 2763-64 (citing *Cort v. Ash* and *Touche Ross*); *Blue Chip Stamps*, 421 U.S. at 736; 421 U.S. at 756 (Powell, J., concurring). This central inquiry simply cannot be circumvented.

2. Congress Did Not Incorporate Private Aiding And Abetting Rights Into Section 10(b) In 1934.

Respondents contend that the 1934 Congress must have contemplated aiding and abetting as included within § 10(b),

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[6] *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353 (1982), likewise provides no support for the Commission's position. The Court there simply held that privity of dealing was not required to impose liability under the Commodity Exchange Act. *Id.* at 394. The relevant defendants were themselves alleged to have engaged in manipulative conduct, unlike aiders and abettors, and were subject to liability as primary violators. *Id.* at 392 n.95, 394 & n.101. *American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp.*, 456 U.S. 556 (1982), is even further removed from the present case, since there the Court was dealing with an express right of action under the Sherman Act and simply applied basic agency principles to that express right. *Id.* at 570.

because as of 1934 aiding and abetting could give rise to criminal liability and had been applied to common law fraud and deceit actions. (Resp. Br. 13-17.) However, inclusion of express aiding and abetting liability in the federal criminal code militates against a finding that Congress intended aiding and abetting to be included within the civil provisions of the 1934 Act. Congress had elsewhere used aiding and abetting language explicitly prior to 1934, and could have done so in § 10(b) had it desired.[7] *See Blue Chip Stamps*, 421 U.S. at 734. Similarly, Congress' explicit creation of secondary liability in private actions against control persons evidences that Congress did not simultaneously contemplate secondary liability within § 10(b).[8]

Respondents' and the Commission's reliance on the state of certain common law actions in 1934 (Resp. Br. 15-17; SEC Br. 10-11) is misplaced. This Court has acknowledged that it was not the design of the 1934 Congress to create the private right of action later implied under § 10(b). *Lampf*, 111 S.Ct. at 2780. It is far beyond the realm of reality to contend that Congress was aware of the state of the common law in 1934 and intended to incorporate general common law standards

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[7] It is certainly not "anomalous," as Respondents assert without support (Resp. Br. 14), for a provision in the securities laws to give rise to criminal liability but not private civil liability. Violation of any provision in the 1934 Act, with only one exception, can give rise to criminal liability pursuant to § 32 of the Act, 15 U.S.C. § 78ff (1988). No court or commentator has seriously suggested that every provision in the 1934 Act should therefore give rise to a private right of action. Indeed, under Respondents' analysis, the Court's decision in *Touche Ross* would have to be considered anomalous, since it held that there is no implied private right of action under § 17(a) of the 1934 Act, which imposes certain reporting requirements violation of which may be a criminal offense under § 32.

[8] Respondents and the Commission argue that § 20, the control person provision, did not preempt any other possible form of secondary liability, citing various cases holding that § 20 did not eliminate potential claims under a theory of respondeat superior. (Resp. Br. 19-20; SEC Br. 9-10.) This is beside the point. Whether or not § 20 should be taken as the exclusive basis for secondary liability under the 1934 Act, the provision reflects a clear congressional intent as of 1934 to impose secondary liability in private actions against employers of primary violators. Congress could have expressed a similar intention to create liability against aiders and abettors, but did not.

within the § 10(b) private right of action *which it never contemplated*.

In addition, this Court has left no question that private rights under the securities laws are not to be implied based upon principles of tort law. As Central Bank observed in its opening brief (Pet. Br. 30-31), the Supreme Court has stated unequivocally that an "argument in favor of implication of a private right of action based on tort principles . . . is entirely misplaced." *Touche Ross*, 442 U.S. at 568. Remarkably, neither Respondents nor the Commission nor Respondents' other amici respond to this controlling language in *Touche Ross*, or even cite *Touche Ross* at any point in any of their briefs.[9] Securities laws and business torts constitute distinct areas of the law. The availability of aiding and abetting liability in any common law action is simply not relevant to the present inquiry, and certainly does not serve to show that the 1934 Congress intended to include aiding and abetting as part of the private rights of action subsequently implied under § 10(b).

3. Congress Has Not Created A Private Right Of Action For Aiding And Abetting Under Section 10(b) Since 1934.

The Commission heavily emphasizes that Congress has not disturbed the lower courts' interpretation of § 10(b) as including a private right of action against aiders and abettors.

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[9] Respondents and the Commission seem to suggest that common law principles may at least be used as a floor below which the protections of the 1934 Act cannot fall. (Resp. Br. 17; SEC Br. 21 n.21.) Thus, common law should not be used to reduce the scope of the securities laws, although common law principles could be used to expand their scope. While this theory could be consistent with *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388-89 (1983), it does nothing to explain *Touche Ross*, 442 U.S. at 568 (refusing to imply a private right of action under § 17(a) of the 1934 Act based on principles of tort law), or *Blue Chip Stamps*, 421 U.S. at 744-45 (refusing to expand § 10(b) rights of action to plaintiffs who were not actual purchasers or sellers, even though the related torts of misrepresentation and deceit did not impose a strict purchaser/seller requirement). *Cf. Lampf*, 111 S.Ct. 2773 (imposing statute of limitations on implied § 10(b) rights more restrictive than statutes of limitations applicable under common law).

(SEC Br. 11-16.) A review of the actions Congress has and has not taken over time demonstrates that, far from embracing an implied private aiding and abetting right, Congress has chosen to incorporate aiding and abetting liability only in disciplinary and criminal contexts.

Between 1957 and 1960, Congress failed to add proposed language to § 20 of the 1934 Act which would have created a private right of action against aiders and abettors of securities violations. *See* H.R. 2480, 86th Cong., 1st Sess. §§ 21, 22 (1959); S. 1179, 86th Cong., 1st Sess. §§ 21, 22 (1959). The Commission observes that this legislation was not intended to address private rights of action, and that the Senate passed a version of the legislation which would have added aiding and abetting to the Commission's rights to seek injunctive relief. (SEC Br. 15.) Respondents similarly argue that the legislation was actually intended to strengthen the Commission's injunctive powers, and notes that in later years aiding and abetting language was added to relevant SEC enforcement provisions. (Resp. Br. 21 n.14.) Each of these facts *supports* the inference that it has at all times been the intention of Congress to include aiding and abetting within the reach of the Commission's disciplinary powers, not within private civil actions. When aiding and abetting language was written broadly enough to encompass private actions, the securities industry objected to the proposal and it was never passed. *See SEC Legislation: Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, 86th Cong., 1st Sess., on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182*, 288, 370 (1959) (Commission memorandum noting industry fears that provision would create private aiding and abetting right and suggesting that it be amended to "[m]ake it clear that no civil liability is intended").

In contrast, in 1964 when the aiding and abetting language was limited to SEC enforcement remedies, the proposal succeeded. (See Pet. Br. 22-23.) Respondents argue that Congress did not need to provide private aiding and abetting rights at the same time it created powers against aiders and abettors in favor of the Commission, since it had reason to

think that the judiciary would develop adequate implied private rights. (Resp. Br. 22 n.14.) However, by 1964, courts had long recognized an implied right of action against aiders and abettors of securities violations in favor of the SEC. *See, e.g., SEC v. Timetrust, Inc.*, 28 F. Supp. 34, 43 (N.D. Cal. 1939). At that time the landmark case first recognizing an implied private right of action against aiders and abettors, *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970), had not yet been decided.[10] If the 1964 Congress had wished both private parties and the Commission to have rights against aiders and abettors, it is the Commission action, not the private action, which it might have felt safe leaving to the courts. Its creation of aiding and abetting liability only in favor of the Commission belies any inference that it also intended analogous private rights.

Respondents and the Commission stress that in 1975, when it made significant changes to the 1934 Act, Congress did not disavow the implied private right against aiders and abettors which some lower courts had by then recognized. While the Court has previously considered congressional inaction in 1975 to provide some evidence of intent, *Herman & MacLean*, 459 U.S. at 384-86, it is certainly not compelling evidence. For instance, in its *Lampf* decision the Court reversed the lower courts' traditional practice of employing an analogous state statute of limitations, even though Congress had not chosen to disavow the practice in 1975. *See* 111 S.Ct. at 2784 (Stevens, J., dissenting) (noting long history of rule applied by lower courts). The 1975 revisions to the 1934 Act provide particularly weak evidence of congressional intent here, for several reasons. First, congressional inaction

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[10] Respondents cite to one prior case, *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963), however this case noted the availability of aider and abettor liability in a single sentence without analysis. The *Brennan* decision has generally been regarded as the case which "first recognized [aiding and abetting liability] in a private civil action under the federal securities laws." (Brief Amicus Curiae of the Association of the Bar of the City of New York in Support of Respondents, p. 12.)

should not be viewed as an endorsement of a statutory interpretation which it has previously declined to codify within the statute. (See Pet. Br. 22 n.15.) Second, in 1975 Congress did add further SEC disciplinary powers reaching aiders and abettors, for which Respondents and the Commission provide no explanation. Third, the private right of action Respondents advocate was hardly settled by 1975. To the contrary, in 1975 the Court rendered its decisions in *Blue Chip Stamps* and *Cort v. Ash*, placing the further expansion of implied private rights under the securities laws in grave doubt.

Subsequent legislative history from 1977 cited by the Commission (SEC Br. 13-14) makes no reference to secondary liability of any kind. Nor can aiding and abetting be considered within the scope of the private cause of action which Congress noted courts had recognized, since by 1977 this Court had expressly reserved judgment as to any such implied right. *Ernst & Ernst*, 425 U.S. at 191 n.7.

The Insider Trading Sanctions Act of 1984, cited by the Commission (SEC Br. 14), provides no support for the Commission's position. By that point the *Touche Ross* decision had been rendered, making it even more dubious that Congress could have considered the existing judicial application of aiding and abetting to include an implied private right of action. Furthermore, that act again created rights only in favor of the Commission against aiders and abettors. The discussion leading up to the statement quoted by the Commission concerning the Committee's endorsement of aiding and abetting is devoted exclusively to SEC enforcement of the securities laws. H.R. Rep. No. 355, 98th Cong., 2d Sess. 9-10 (1983), *reprinted in* 1984 U.S.C.C.A.N. 2274, 2282-83. The subsequent paragraph goes on to list the many remedies available against aiders and abettors of the securities laws, but implied private rights of action are conspicuously absent from the list. *Id.* at 10. Finally, the act's secondary liability provisions were sharply limited, and the Commission itself explained that the existing SEC remedies against aiders and abettors under § 15 of the 1934 Act were sufficient to provide ample deterrence against aiding and abetting violations. *Id.* at 28. This hardly constitutes a ringing endorsement of broad private rights of

action against aiders and abettors, but instead reinforces the view that Congress has consistently determined SEC disciplinary powers to provide adequate means of dealing with aiders and abettors. In 1986 SEC remedies against aiders and abettors were again added to the 1934 Act, further supporting this interpretation.

The language of the Insider Trading and Securities Fraud Enforcement Act of 1988 quoted by Respondents and the Commission (Resp. Br. 25-26; SEC Br. 14-15), has already been interpreted by this Court as "an acknowledgement of the 10b-5 action without any further expression of legislative intent to define it." *Musick*, 113 S.Ct. at 2089. The Commission would have the Court now read more into the statement than is warranted by its context. The statement is contained in a footnote which reflects the Committee's intention that its limitation of respondeat superior liability in the insider trading context should "not affect the applicability of the respondeat superior theory in Commission actions or under the federal securities laws generally." H.R. Rep. No. 910, 100th Cong., 2d Sess. 27 n.23 (1988), *reprinted in* 1988 U.S.C.C.A.N. 6043, 6064 n.23. The note then adds, "Similarly, it does not affect the availability of any other theories of liability, such as aiding and abetting or the failure to supervise, in appropriate circumstances." *Id.* The passage may be read simply as a reference to the Commission's express rights of action for aiding and abetting. At best, the footnote is ambiguous. The Court "should not condone the implication of any private action from a federal statute absent the most compelling evidence that Congress in fact intended such an action to exist." *Cannon v. University of Chicago*, 441 U.S. 677, 749 (1979) (Powell, J., dissenting). This footnote's single relevant sentence hardly qualifies as "compelling evidence."

Finally, SEC disciplinary powers against aiders and abettors of certain securities violations were once again added in 1990. The persistent congressional pattern of incorporating aiding and abetting into the securities laws only in the criminal and disciplinary contexts continues to this day. Congress has repeatedly had the opportunity to create express rights

against aiders and abettors in favor of both the Commission and private parties, and it has chosen to grant only the former.

C. Policy Considerations Do Not Warrant Creation Of An Implied Private Right Of Action For Aiding And Abetting.

The Commission argues that policy considerations support implication of an implied private right of action against aiders and abettors of violations of § 10(b). (SEC Br. 16-17.) The Commission again relies on the outdated philosophy of *J.I. Case Co. v. Borak*, and on the lower courts' acceptance of an aiding and abetting theory based on tort principles which this Court has since invalidated as a basis for implying new rights under the 1934 Act.[11] The Commission's policy arguments cannot provide a basis for an implied private right of action against aiders and abettors, and even if this issue were to be decided on policy considerations, significant concerns weigh against recognition of a private aiding and abetting right.

Similar policy considerations were presented by the parties in *Musick* and were rejected flatly by the Court, which held that its "task is not to assess the relative merits of the competing rules." 113 S.Ct. at 2089. In *Touche Ross*, the Court noted, "The ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." 442 U.S. at 578. The Commission's policy views, even if accepted by the Court, cannot justify judicial creation of an implied private right of action against aiders and abettors.

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[11] Respondents also rely heavily on the lower courts' acceptance of an aiding and abetting cause of action to establish that such an action does not interfere with the effective operation of the securities laws. (Resp. Br. 26-29.) This reverses this Court's sequence of analysis followed in the recent past, under which the primary inquiry is one of congressional intent. Only after a basis is found for concluding that the 1934 Congress would have wished a right to be included does the Court consider whether recognition of the right might interfere with operation of the securities laws. *Musick*, 113 S. Ct. at 2089-92.

Furthermore, to the extent that policy implications are considered, the Court has gone beyond the Commission's emphasis on ensuring maximum enforcement of the securities laws. In *Blue Chip Stamps* and *Virginia Bankshares*, the Court was at least as concerned with the danger of speculative securities claims. 421 U.S. at 738-749; 111 S. Ct. at 2764-65. As in *Virginia Bankshares*, the claims here are made possible by the lack of any rigorous causation requirement. Under Respondents' theory, Central Bank's substantial assistance of the alleged fraud is little more than "but for" causation: But for Central Bank's agreement to delay a new appraisal, the insufficiency of the security for the bonds would have been exposed and the bonds would not have been issued and sold to Respondents. Proof of such inferences as to what might have been would require the same type of guesswork and unreliable evidence that the Court disapproved in *Virginia Bankshares*, 111 S.Ct. at 2765, and would open the doors of the federal courts to an entire class of unduly speculative claims.[12]

II. LIABILITY FOR AIDING AND ABETTING A VIOLATION OF SECTION 10(b) AND RULE 10b-5 SHOULD NOT BE IMPOSED BASED ONLY ON RECKLESSNESS IN THE ABSENCE OF A PRE-EXISTING DUTY TO DISCLOSE OR TO ACT.

The court below held that Central Bank could be liable for aiding and abetting based upon mere recklessness because

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[12] The Commission's response to the threat of speculative or vexatious claims is to call for unspecified safeguards to reduce such claims and, if unsuccessful, to allow Congress to reduce or reject the implied aiding and abetting private right. (SEC Br. 16-17.) The Commission again would turn this Court's analysis on its head. Given the complete lack of congressional intent to impose aiding and abetting liability in § 10(b) or analogous sections embodying express private rights and its countervailing intent to confine aiding and abetting liability to criminal and disciplinary actions, it should be left to Congress to determine whether it wishes to *create* aider and abettor liability in private § 10(b) cases and what the appropriate limitations upon such liability should be.

Central Bank's conduct included an affirmative act. Respondents and the Commission defend the court's outcome because in their view recklessness should always be sufficient scienter for aiding and abetting. Both of these approaches are flawed. They are both far afield of the requirement of deceptive or manipulative conduct by the defendant and both would permit liability in cases, such as this one, where the defendant owed no pre-existing duty to the plaintiffs and committed no affirmative misrepresentation.

A. Aiding And Abetting Liability May Not Appropriately Be Premised On Recklessness In All Cases.

In the context of aiding and abetting liability, as opposed to primary liability, under § 10(b), the various courts of appeals uniformly have permitted liability based on recklessness only where some condition is met to render recklessness an appropriate standard of scienter. The majority of circuits require a pre-existing duty to disclose or to act owed by the defendant before recklessness will be considered sufficient. (Pet. Br. 39-40.) The Seventh Circuit requires something more, that the defendant meet all requirements for primary liability except that he need not have actually purchased or sold securities. *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986). The Ninth Circuit requires some affirmative misrepresentation by the defendant before a recklessness standard will be imposed. *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1484 & n.4 (9th Cir. 1991). Surprisingly, Respondents, the Commission, and Respondents' other amici for the most part abandon any such conditional scienter test for aiders and abettors. Their extreme position, by equating the culpability of primary violators with that of aiders and abettors in *all* instances, ignores the mandate of *Ernst & Ernst*, which requires a finding of deceptive conduct by the defendant, and would lead to unwarranted results.

The Commission notes that every court of appeals has accepted recklessness as an adequate scienter standard for

primary liability under § 10(b), an issue not before the Court today, but then goes on to argue that the scienter test for aiding and abetting should be the same as that for primary liability.[13] (SEC Br. 22-24.) Each of the lower courts, whose decisions the Commission argues should be given "considerable weight" for purposes of implying a private aiding and abetting right (*id.* at 17), requires some additional condition before it will apply the recklessness standard used generally in primary liability cases to the context of aiding and abetting. (See summary of lower courts' approaches at Pet. Br. 38-45.) As will be seen, without regard to what might be an appropriate standard of scienter for primary liability, recklessness does not adequately meet the requirements of the statutory language as interpreted in *Ernst & Ernst*, in cases such as this where the defendant owed no duty to disclose or to act and made no misrepresentations to the plaintiffs.

Respondents argue that a recklessness standard[14] is in accordance with the intent of the 1934 Congress, because a recklessness standard was often used in common law actions in 1934 (Resp. Br. 33-35, 39-42) and because express liability provisions of the 1934 Act require no more than recklessness

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[13] In support of using the same standard in both contexts, the Commission stresses that the recklessness standard comports with the broad remedial purposes of the securities laws (SEC Br. 24), again failing to apprehend that the issue today is not one of policy, but of statutory interpretation.

[14] Respondents consistently contrast the general recklessness standard they advance with the "high conscious intent" standard Central Bank supposedly endorsed. (*See, e.g.*, Resp. Br. 29 ("Petitioner contends that the Tenth Circuit should have employed a 'high conscious intent' standard.").) Central Bank made no such contention. Central Bank argued in its opening brief simply that recklessness is not sufficient scienter for aiding and abetting in the absence of a duty to disclose or act. While the Court need not reach the issue, under the rule applied by most of the lower courts, a standard of actual knowledge is used in the absence of such a duty. This standard rises to conscious intent where the defendant's substantial assistance of the fraud is accomplished by inaction. *See* Joel S. Feldman, *The Breakdown of Securities Fraud Aiding and Abetting Liability: Can a Uniform Standard Be Resurrected?*, 19 Sec. Reg. L.J. 45, 53-57 (1991).

(Resp. Br. 36-39).[15] Respondents' reliance upon express liability provisions within the 1934 Act is the reverse of the approach this Court took with respect to such provisions in *Ernst & Ernst*. In dealing with the issue of whether negligent conduct could suffice under § 10(b), the Court pointed out that Congress had created express remedies which reached certain negligent conduct but imposed procedural restrictions not found in § 10(b). 425 U.S. at 208-09. Thus the Court concluded that § 10(b), which has no such restrictions, could not be extended, consistent with the intent of Congress, to actions premised on negligent conduct. Following this analysis, Respondents' contention that express liability provisions of the 1934 Act require no more than reckless conduct leads to the conclusion that Congress likely would have intended a greater scienter standard for the § 10(b) "catchall" remedy.

Respondents' use of common law principles to demonstrate congressional intent in 1934 or the proper scope of § 10(b) liability is also flawed.[16] Their assertion that Congress must have intended the scienter standard in implied private actions under § 10(b) to match that of certain common law actions existing in 1934 goes even beyond the "pretense" the Court disavowed in *Lampf*, 111 S.Ct. at 2780. Congress did not contemplate any private remedy, let alone a remedy for aiding and abetting, when it created § 10(b), nor should the terms of § 10(b) necessarily be construed in accordance with common law principles. *See* discussion, *supra*, at 7-8. Furthermore, Respondents' and the Commission's reliance on the principle at common law that reckless misrepresentations are actionable, *see, e.g.*, *Cooper v. Schlesinger*, 111 U.S. 148, 155 (1884) ("a statement recklessly made, without knowledge

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[15] Respondents also note that the Court found in *Ernst & Ernst* that § 10(b) liability may not be imposed where the defendant acted in good faith. (Resp. Br. 35-36.) Obviously, this rule would not be violated by a finding that scienter greater than mere recklessness is required to impose aiding and abetting liability.

[16] *Ernst & Ernst* reserved the question of whether recklessness could meet the § 10(b) scienter requirement and merely noted that under certain areas of the law recklessness is treated as intentional conduct. 425 U.S. at 193 n.12. This was *not* an endorsement of applying general common law concepts to § 10(b).

of its truth, [is] a false statement knowingly made"), is misplaced. In the context of affirmative misrepresentations made in reckless disregard of the truth, recklessness might fairly be said to demonstrate an intent to mislead. However, Central Bank is accused of an entirely different brand of recklessness far removed from such forms of affirmative deception. The false and misleading statements alleged in this case were made in disclosure documents which were not prepared by Central Bank. Central Bank is not alleged to have made any false statements to investors, recklessly or otherwise. Instead, the bank is accused of recklessly choosing to delay an independent appraisal which allegedly allowed the fraud to occur.

The facts of this case illustrate the extreme results which are possible under a scienter standard of recklessness applied in all instances. Under such a rule a defendant may be held liable for aiding and abetting a violation of § 10(b) where, as here, he was under no duty to disclose or to act and where he made no affirmative misrepresentations. None of the courts of appeals have been willing to follow such an extreme approach. More importantly, this is not the type of manipulative or deceptive conduct contemplated by the Court's decision in *Ernst & Ernst* or the language of § 10(b).[17]

B. Central Bank Should Not Be Subject To Liability Based On Recklessness Merely Because It Committed Some "Affirmati e Act," Where It Owed No Pre-Existing Duty To Disclose Or To Act.

Respondents pay lip service to the basis of the lower court's decision by arguing that the question of Central Bank's duty to disclose or act is irrelevant, "particularly" where it committed an affirmative act. (Resp. Br. 42-46.)

[17] In addition to the statutory language, Respondents improperly rely on the language of Rule 10b-5. Respondents themselves note that the Rule would permit § 10(b) liability based on unintentional conduct, which is obviously not proper. This Court has held that the wording of the Rule is not an appropriate determinant of permissible standards for § 10(b) liability. *Ernst & Ernst*, 425 U.S. at 214 ("despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)").

However, Central Bank's conduct, which violated no pre-existing duties, is not transformed into the type of manipulative or deceptive conduct contemplated by *Ernst & Ernst* simply because the court of appeals chose to characterize its conduct as an "affirmative act." Respondents argue that Congress did not contemplate a sliding scale scienter requirement under which liability based on recklessness would be allowed only in the face of a pre-existing duty to disclose or to act, but Respondents cannot avoid the fact that Congress *did* contemplate that § 10(b) would apply only to those guilty of manipulative or deceptive conduct. If recklessness ever rises to this level, it can do so only where the defendant's conduct is in the nature of manipulation or deception because by its reckless acts the defendant disregarded a pre-existing duty to the plaintiff. Where there was no pre-existing duty creating the expectation that a defendant would act to protect the plaintiff's interests, a defendant's failure to uncover and stop the fraud of another is not a form of manipulation or deception.[18]

In the absence of a pre-existing duty, the defendant's conduct is not rendered manipulative or deceptive simply by the talismanic effect of any affirmative action. Respondents attempt to create this result by bootstrapping a duty from the fact that Central Bank took some affirmative action. (Resp. Br. 44-45.) This does not give rise to any duty which might render Central Bank's conduct manipulative or deceptive. Central Bank did not itself commit any affirmative misrepresentation. *Compare Levine*, 950 F.2d at 1484 n.4. Central Bank is not accused of taking an action which made Respondents' situation worse. *Compare* W. Prosser, *The Law of Torts* § 339 (3d ed. 1964). Rather, Central Bank is accused of agreeing to delay taking an action, obtaining an independent

[18] This is directly analogous to the conclusion that a failure to speak may become actionable in light of a pre-existing duty to disclose. *Chiarella v. United States*, 445 U.S. 222 (1980). The Commission's attempts to distinguish the two situations (SEC Br. 24 n. 27), misses the mark. While the primary violators in this case may have made affirmative misrepresentations, Central Bank did not. Without some pre-existing duty governing its conduct, Central Bank's failure to discover the misrepresentations, even if reckless, is not a violation of § 10(b).

appraisal, which might have made Respondents' situation better by allegedly preventing the bond issue from going forward.[19] This is not conduct which may fairly be described as manipulative or deceptive. If such tenuous "affirmative actions" are accepted as the basis for aiding and abetting liability based on recklessness, then banks, accountants, lawyers, and other parties to securities transactions will have little protection against investors who might second guess their conduct, claiming that their actions, though fully in accord with their state law duties, nonetheless allowed the fraud to occur. The Tenth Circuit's opinion, which subjected Central Bank to potential liability based on just this type of speculative reasoning, should be reversed.

Respectfully submitted this 13th day of October, 1993.

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[19] Again, Central Bank's conduct as easily could be described as a failure to insist upon an independent appraisal. Agreeing to delay some event is not the type of "action" which might in other circumstances generate "bystander" liability (SEC Br. 26 n.30), and such insubstantial "affirmative acts" provide no logical or workable basis for subjecting a defendant to liability for recklessly aiding and abetting a securities fraud. To the extent the Commission follows the Tenth Circuit's "affirmative action" standard (*see* SEC Br. 19 n. 18), it has forfeited any claim to a "flexible, predictable approach." (*Id.* at 24-30.)